

OPEN MEETING AGENDA ITEM
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MEMORANDUM

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Arizona Corporation Commission

DOCKETED

TO: THE COMMISSION

AZ CORP COMMISSION
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FROM: Utilities Division

FEB 03 2005

DATE: February 3, 2005

DOCKETED BY

KV

RE: UPDATE ON SOUTHWEST GAS FILING FOR APPROVAL OF A
TEMPORARY PURCHASED GAS ADJUSTOR SURCHARGE (DOCKET NO.
G-01551A-04-0818)

On November 15, 2004, Southwest Gas Corporation (Southwest) filed for Commission approval of a temporary \$0.04254 per therm purchased gas adjustor (PGA) surcharge due to high natural gas prices. On December 14, 2004, the Commission approved a \$0.02 per therm PGA surcharge effective January through December 2005. The Commission further ordered that "Staff and Southwest should report back to the Commission at the February 8 and 9, 2005 Open Meeting regarding the status of the PGA bank balance, natural gas market conditions, and other relevant issues."

This memorandum summarizes Staff's perspective on Southwest's PGA bank balance, natural gas market conditions, and other relevant factors at this time. In early December 2004, when the Commission approved the \$0.02 per therm PGA surcharge, natural gas prices had been relatively high going into the winter heating season, but the natural gas markets had not seen any major price blowouts and there was a high degree of uncertainty regarding natural gas prices through the rest of the winter.

Regarding Southwest's PGA bank balance, at the time of the December 2004 Open Meeting, Southwest's latest known PGA bank balance was the end of October 2004 PGA Bank balance which was undercollected by \$3,458,414. Southwest's projections at the time indicated that its undercollected PGA bank balance would exceed the \$22.4 million threshold at the end of January 2005 and continue to increase in the following months.

Since that time natural gas prices have been moderately lower than Southwest's projections and Southwest's more recent price projections, while still relatively high, are lower than what was expected in December 2004. The status of Southwest's hedging activities has not changed significantly since the December Open Meeting. Due to the moderately lower natural gas prices in the last couple months, Southwest's undercollected PGA bank balance has increased at a moderately slower rate than had been projected in December. The most recent PGA bank balance available is the end of December 2004 balance which is undercollected by \$15,278,403. Southwest's projections now show the PGA bank balance will exceed the \$22.4 million threshold in February 2005, but will hover near the threshold through the end of 2005. This is noticeably lower than the previously projected bank balances through 2005.

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In effect, at this time it appears that continuation of the \$0.02 per therm PGA surcharge through 2005 will keep the PGA bank balance near the threshold level, which is a significant undercollection, but less than previously projected.

Regarding market conditions, a relatively mild winter overall to this point has mildly dampened natural gas demand nationally, although recent cold weather in the northeast and Midwest led to spot market prices at some northeastern delivery points reaching \$20 to \$30 per MMBtu at times. These price spikes have been localized and have not spread to the supply basins where Southwest acquires its supplies. Natural gas storage inventories continue to be relatively high and most natural gas production in the Gulf of Mexico which was disrupted by Hurricane Ivan has now returned to production. January 2005 rig counts are approximately 10 percent above prior year levels, although the resulting impact on total production is unclear. On the other hand, continued high world oil prices have exerted upward pressure on natural gas prices and a cold latter part of the winter building off of the recent cold weather in the major consuming regions could yet lead to higher natural gas prices in 2005. At this time price projections for 2005 are tending to be in the \$5.00 to \$6.00 range or nearby. The Energy Information Administration's January 2005 Short Term Energy Outlook projects an average 2005 natural gas price of \$5.77 per mcf and \$5.95 per mcf in 2006. As of February 2, 2005, the daily spot market index prices for El Paso Permian was \$5.86 per MMBtu and for El Paso San Juan Basin was \$5.635 per MMBtu. It appears that absent a cold late winter or major unforeseen market disruption, the natural gas prices for the winter 2004-2005 will avoid any major prices spikes in the supply basins where Southwest acquires its supplies.

In summary, Staff believes that given current PGA bank balance projections and market conditions, continued retention of the \$0.02 per therm PGA bank balance through 2005, as approved by the Commission in December 2004 is reasonable.



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Director
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EGJ:BG

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